



All Along the Clocktower

VOLUME II - SPECIAL REPORT

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War and Peace, Crime and Punishment, and... *The Idiot*

Key Takeaways:

- Many in the West are surprised by the Wagner mutiny given chronic overestimation of Moscow's capabilities, a symptom of the West's Russophobia.
- In our controversial view, Russia invaded Ukraine for petty reasons, trying to forestall precisely the political unravelling that its botched invasion has now caused.
- While Western commentators are now reacting with glee to the mutiny, they should think twice about exhibiting outward *schadenfreude*.
- The West cannot have it all, it cannot de-risk from China and solve climate change – both capex-heavy and commodity-needy preferences – *and* see Russia collapse at the same time.
- A price will have to be paid – in inflation and in a commodity bull market – for the modern version of the *Time of Troubles* in Russia.
- Tactically, we see very few scenarios where a Ukrainian offensive is successful, an outcome that the market is already priced for.
- Our favorite way of harvesting geopolitical alpha – by fading all risks associated with this conflict – has worked extremely well but is now fully priced. Even though we see no imminent risks, it is prudent to start thinking about hedging against them given market pricing.

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The June 23-24 Wagner mutiny has laid bare the political dysfunction in Russia that we have been flagging since Moscow's troops crossed Ukrainian borders on February 24, 2022. In our view, Moscow invaded Ukraine for petty – rather than profound – reasons.¹

This view puts us in a strange position where we disagree both with the Russia apologists and the consensus in the West. In other words, we neither agree with the view that President Putin was forced to invade Ukraine out of defensive necessity due to NATO expansion nor that he was trying to reconstruct a Soviet sphere of influence. Instead, the Kremlin invaded Ukraine to forestall precisely the unraveling that is now occurring in Russia. But, instead of forestalling it, Russia's bungled invasion has accelerated it.

It is difficult to take seriously the view that the Russian invasion has gone smoothly or according to some version of the Kremlin's original plans. Casualty figures are steeped in propaganda, but the estimate is somewhere between 40,000 and 150,000 Russian soldiers dead.² This is an astonishing number. In the three decades of warfare in Afghanistan (1979-1989) and Chechnya (First Chechen War from 1994-1996 and the Second Chechen War from 1999-2009), Russia lost somewhere between 25,000 to 75,000 troops, *combined* – again depending on whose propaganda one believes. That suggests that Russia has either lost the same number of soldiers it lost in three decades of war or *eight times* as many troops in the past 18 months. Both the war in Afghanistan and the two Chechen wars had a profound effect on Russian domestic politics, with each essentially ushering in a regime change (relatively peaceful in both instances).

In the West, the Wagner mutiny has come as a surprise, revealing a level of overestimation of Russian capabilities that has been one of the historical hallmarks of Western paranoia about Russia. Surprise has been accompanied by glee, as commentators project linearly from the Yevgeny Prigozhin rebellion to some sort of post-Putin future. While *schadenfreude* may be an expected human emotion given the civilian casualties in Ukraine, investors may want to hold the celebration.

As far as the market is concerned, the war in Ukraine has been over for months. All of the geopolitical risk premium has drained from the market. However, a weakened Russia opens up several scenarios that could see risk premium seep back into the markets. It also threatens to derail the capex-driven cycle that depends on the availability of commodities to fuel the many policy prerogatives of Western policymakers – from de-risking supply chains away from China to transitioning to a green energy future.

War and Peace – The War in Ukraine Is Already Over

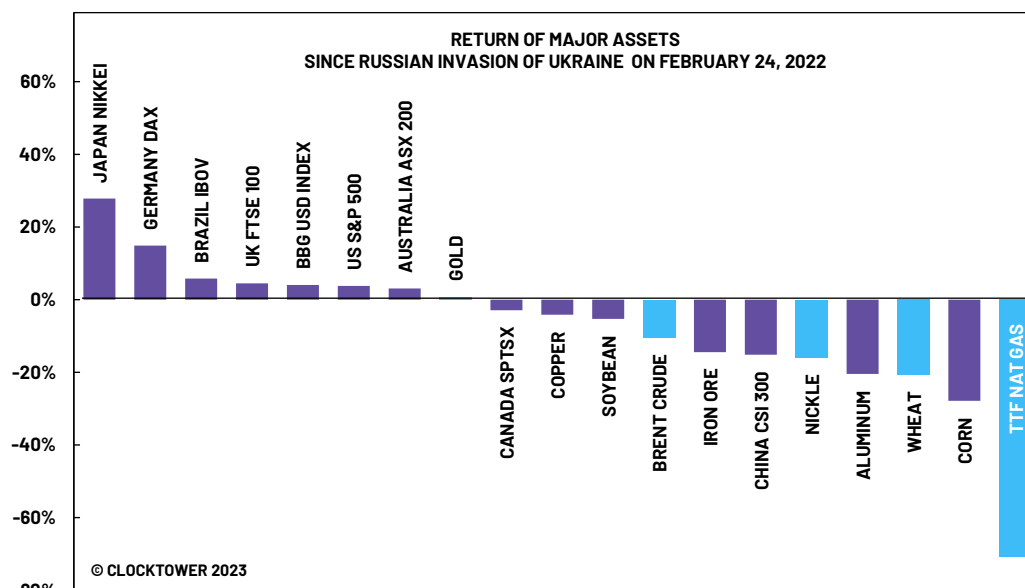
As far as the market is concerned, the war in Ukraine has been over for over half a year.

Chart 1 shows that there is not much geopolitical alpha left as the war-sensitive assets such as gas, wheat, and oil have all fallen below the pre-invasion levels, while European equities have recovered above pre-invasion levels.

¹ Please see Clocktower Group, *Flash Report*, "No, Putin Is Not Playing Chess... He Is Playing Checkers," dated September 23, 2023, available on request.

² Please see Reuters, "[Ukraine war, already with up to 354,000 casualties, likely to last past 2023 – U.S. documents](#)," dated April 13, 2023, available at [reuters.com](#).

CHART 1 | The War in Ukraine Is Irrelevant, that Is What the Market Is Telling Us



NOTE: BLUE BARS ARE GEOPOLITICALLY SENSITIVE ASSETS TO RUSSIA-UKRAINE WAR. DATA AS OF JULY 2, 2023. SOURCE: BLOOMBERG FINANCE L.P.

Our calls throughout the war have been to *fade* geopolitical risk premium, betting that the half-life of the panic would be short-lived given the overwhelming material constraints facing Russia. As such, we shorted long-dated US bonds at the onset of the war, a controversial view given that the US 10-year Treasury note is the staple geopolitical safe haven asset (Chart 2).³ Our view, at the onset of the conflict, was that President Putin was ignoring his material constraints, that these constraints cannot be wished away, and that they would whipsaw the Kremlin back into a reality. A reality that bounds the conflict and forces it into a largely geopolitically irrelevant corner of Europe (Eastern Ukraine). There were many other reasons for bonds to sell off in early March – from a hawkish Fed to sticky inflation – but had the Russia-Ukraine conflict been as profound as many expected – and as boundless by constraints and as motivated by Putin’s preferences – there is no way that Jay Powell would have mattered more than the Kremlin. We subsequently shorted oil in June 2022 (Chart 3)⁴ and went long European assets in September 2022, at the height of the “Europe is de-industrializing” panic (Chart 4).⁵

Besides major assets, is there any remaining alpha in peripheral assets? Is there any geopolitical risk premium left to “fade?”

Chart 5 shows that there probably still is, but the alpha opportunity is thin. Eastern European equities have not fully recovered to pre-invasion levels, but they are really just a step away from doing so. The same story applies to European industrials relative to their US peers (Chart 6), our favorite trade back in September when we recommended it. That said, if the war were to magically end tomorrow, the sudden burst of optimism could cause a playable overshoot in these assets.

³ Please see Clocktower Group, *Flash Report*, “Some Non-Linear Thoughts: Putin’s End, China’s Time, Return of Realpolitik, and the Coming Bond Carnage?” dated February 24, 2022, available on request.

⁴ Please see Clocktower Group, *Flash Report*, “Oil Prices, Multipolarity, and Ukraine,” dated June 20, 2022, available on request.

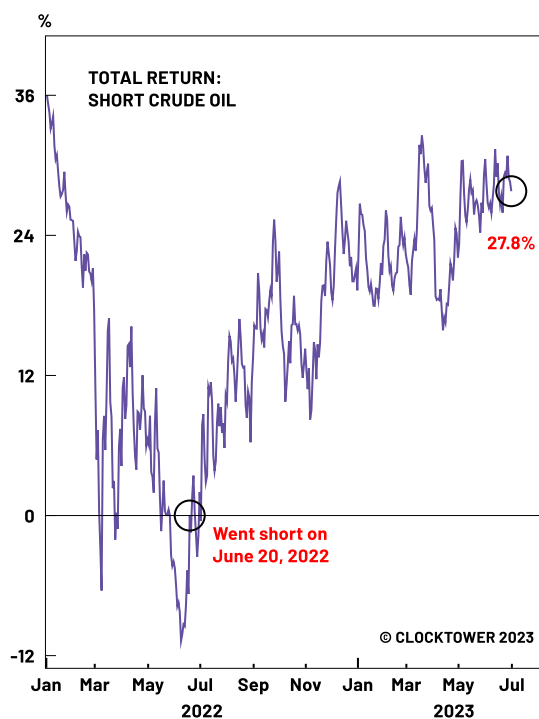
⁵ Please see Clocktower Group, *All Along the Clocktower*, Volume I, “Math Is for Suckers,” dated September 2022, available on request.

CHART 2 | 10-Year Yield Ignored the War...



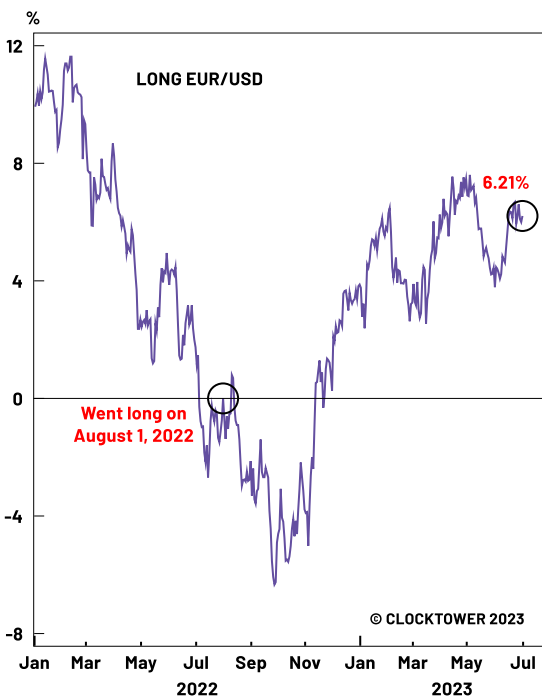
SOURCE: MACROBOND.

CHART 3 | ...It Took Oil a Bit Longer...



SOURCE: MACROBOND.

CHART 4 | ...European Hysteria Lasted the Longest



SOURCE: MACROBOND.

CHART 5 | E. Europe Retains *Some* Risk Premium

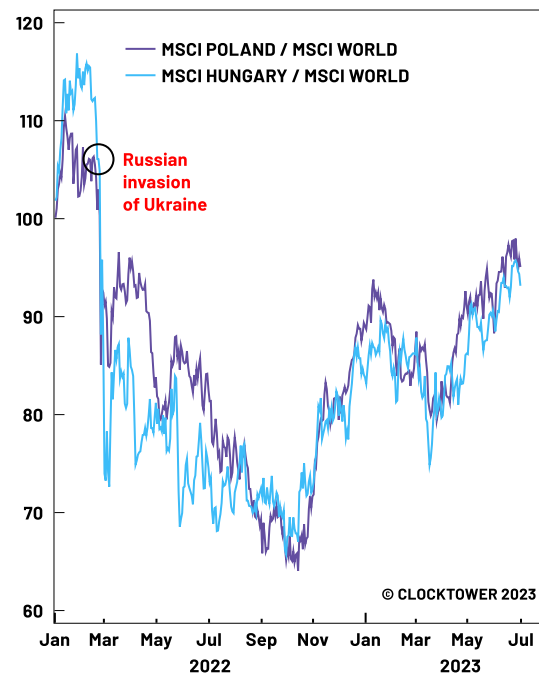


CHART 6 | Perhaps Some Risk Premium Remains in European Equities, but Not Much

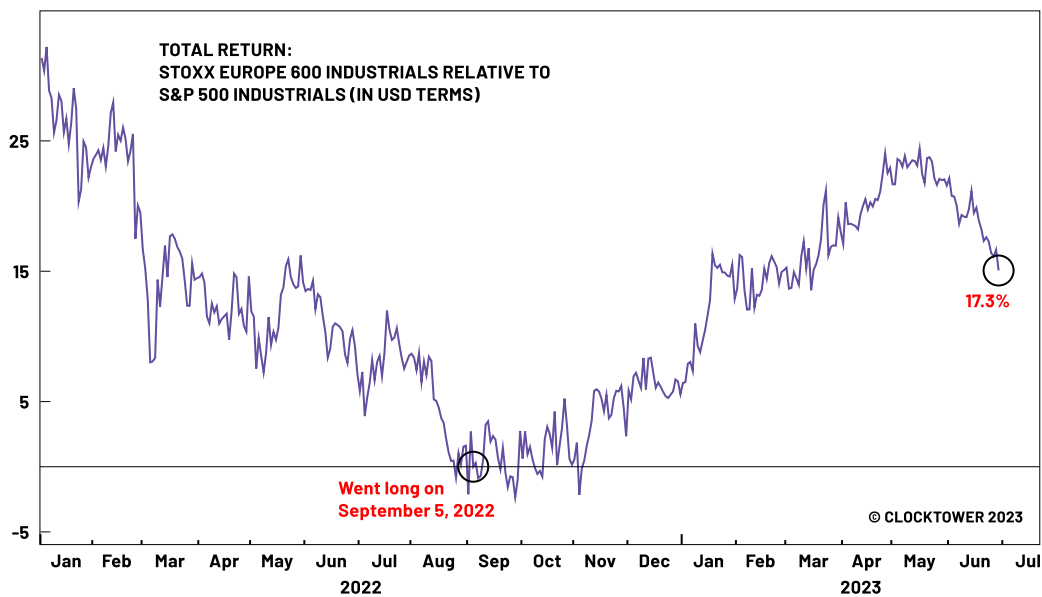
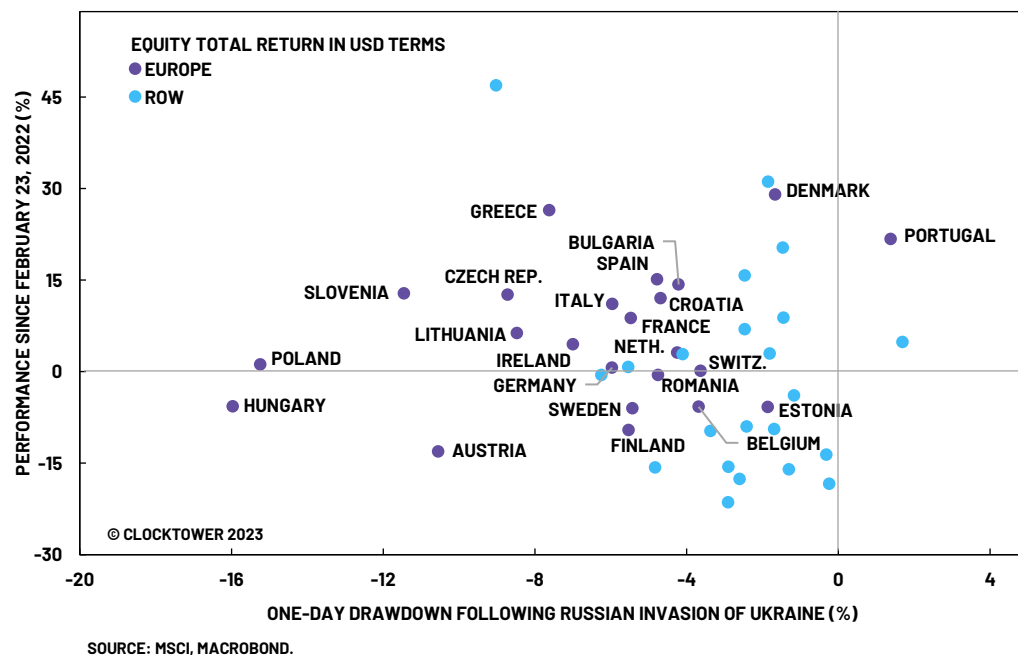


Chart 7 compares equity performance by country since the war with the market drawdown immediately following the war. Of the countries with the largest drawdowns in the aftermath of the invasion – Hungary, Poland, Slovenia, Austria, and Czech Republic – only Hungary, Austria, and Poland have not outperformed their pre-war levels. Sweden and Finland are also two markets that have not yet recovered to their pre-war levels and also had relatively large drawdowns at the onset of the war.

CHART 7 | Central and Eastern Europe, Plus Some Nordics, Could Be the “Fade” if War Is Over Tomorrow



Could there be an alpha opportunity in Taiwan, which in theory may have been negatively impacted by the war in Ukraine as investors – extremely erroneously, in our high conviction view – project a higher probability of war in East Asia due to Moscow’s actions? **Chart 8** illustrates that the war did not really have a notable impact on Taiwanese assets, which have been trading closely to the global semiconductor cycle.

There has been a significant divergence between Taiwanese equities and US semiconductor stocks in the past few weeks, which is obviously caused by investor enthusiasm over AI. It is not clear to us whether this divergence is sustainable given that, in theory, the tide of the AI revolution should lift all the boats, especially those manufacturing most of the advanced chips, namely the Taiwan-domiciled TSMC. As such, we think the divergence either suggests that US semi stocks have gone into a mania or that investors are pricing in sustained geopolitical risk premium in Taiwanese assets. If it is the latter, the end to the war in Ukraine may catalyze a catch-up rally in TSMC relative to US-based stocks.

Chart 9 is our standard chart showing the geopolitical risk premium priced in Chinese equities. It is unclear whether the end of the war in Ukraine would help generate geopolitical alpha in Chinese equities given that the risk is not solely dependent on China’s alliance with Russia. In our view, there is almost nothing that China can do to satiate US policymakers. We see much of the US aggression towards China as a derivative of American domestic politics.⁶ As such, we doubt that the end of the war in Ukraine would help generate alpha in Chinese assets (but Beijing stimulus might!).⁷

CHART 8 | Taiwan Could Be a Catchup Play...

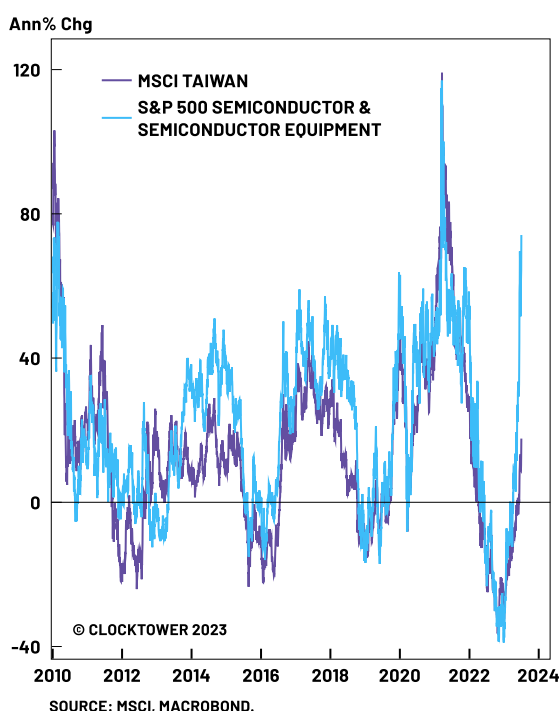
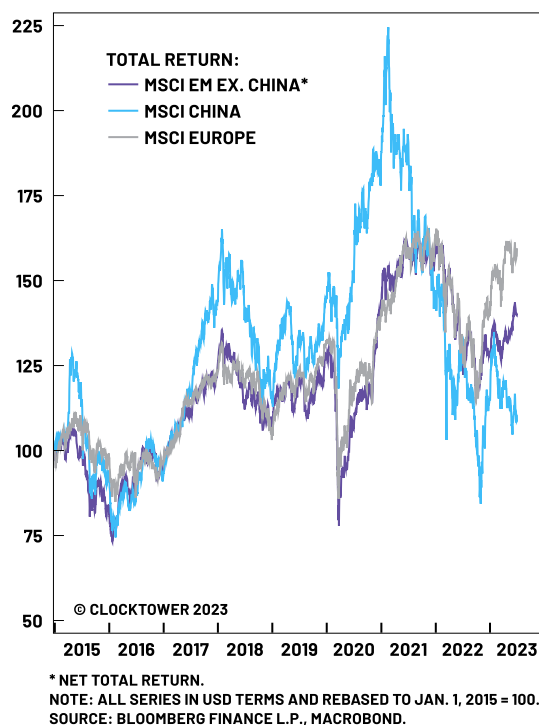


CHART 9 | ...China Most Certainly Is



⁶ Please see Clocktower Group, *Flash Report*, “The Sullivan Doctrine: Machiavellian America Rises,” dated June 22, 2023, available on request.

⁷ Please see Clocktower Group, *China Macro Watch*, “Trust Constraints, Not Rumors & An Onshore Perspective on Russian Mutiny,” dated June 26, 2023, available on request.

Could the Ukrainian offensive change our mind that the war is essentially over? It is our high conviction view that the answer is *no*.

If there is anything the last 18 months has taught us, it is that the war in Ukraine favors defense over offense. The initial Russian attack was stymied by a valiant Ukrainian effort with only limited aid from the West. The Ukrainian offensive in the Summer and Autumn 2022 had some notable successes early, but then was itself bogged down. The Russian offensive in the Winter 2022 and early 2023 descended into World War One-style trench warfare. Since September 2022, the borders of the conflict have been largely static.

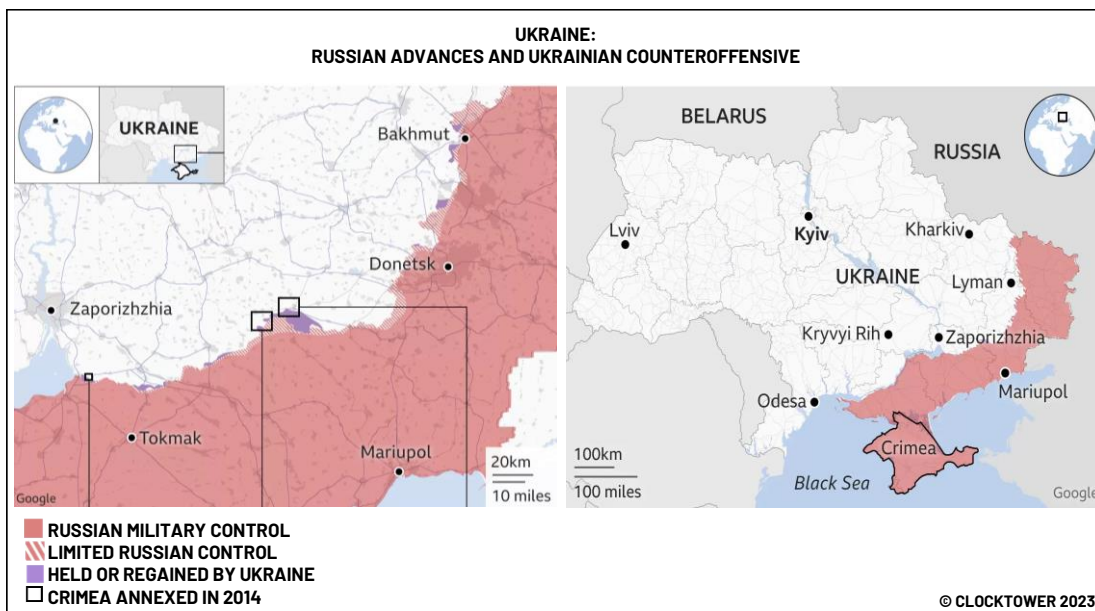
There are five reasons for this development.

- **Experience:** Neither Ukraine nor Russia has much experience with large-scale land warfare. Russian intervention in Syria was mostly in the form of air support for President Bashar al-Assad's government ground forces. Its intervention in Georgia in 2008 was not large-scale at all (and was an organizational disaster to boot). The Russian invasion of Ukraine in 2014 was not impressive. Ukrainian troops held Russian-backed separatists and other irregulars under Moscow's control from linking up newly conquered territories in Donbas with Crimea.
- **Exhaustion:** Both sides are quite exhausted following over 18 months of war. Both Russia and Ukraine have lost some of the most battle-hardened and experienced troops in the first year of war. The battle for Bakhmut, a town in Donetsk oblast, has drained both. This means that Ukraine is now launching a complicated offensive involving a number of new platforms with relatively new recruits.
- **Air Capabilities:** Russia never established total air superiority over northern Ukraine, making its thrust towards Kyiv from the Belarus border a much more difficult exercise than it should have been. Certainly far more complicated than any US invasion over the past three decades. Meanwhile, Russia *does* have air superiority over the territories it has conquered in the south and east of Ukraine, making Ukrainian mechanized armor easy targets for Russian advanced helicopter gunships – the Mi-24 “Hind” and perhaps the world’s most advanced helicopter, Ka-52 “Alligator” – and plentiful ground-attack aircraft – Su-24 “Fencer” and Su-25 “Frogfoot.” Would providing Ukraine with F-16 “Fighting Falcon” fighter jets dent Russian air superiority in the south and east? Highly unlikely. The territories that Russia conquered and is now defending against the Ukrainian offensive are well within the range of Russian S-400 surface-to-air missile (SAM) systems, one of the world’s most advanced air defense platforms. Ukrainian air force cannot operate near Russian borders, no matter what kind of an advanced platform its Western backers gift it.
- **Technology:** A number of new military terms has entered the lexicon of “weekend geopolitical strategists:” unmanned aerial vehicles (UAVs), drones, man-portable air defense systems (MANPADS) – such as the US made FIM-92 “Stinger” or a variety of Russian versions – and man-portable anti-tank systems (MANPATS) – such as the now infamous FGM-148 “Javelin.” These weapon systems have become quite advanced, accurate, and are relatively cheap. Their use in this war has made swift offensive operations by mechanized troops difficult, bogging the conflict in trench warfare. Western media has hailed the use of MANPADS and MANPATS by Ukrainians but has not acknowledged that Russians possess the same tools themselves, bidding up expectations of the Ukrainian offensive when the real takeaway of the past 18 months should have been that these technologies are likely to create a stalemate.

- **Manpower Parity:** The probably least understood reason why the conflict has been ossified since late 2022 is that Russia and Ukraine have parity in terms of manpower. This point confuses many armchair generals, but the reality is that one country is fighting for its existence and the other invaded its neighbor for petty, not existential reasons. The simplest reason why we do not believe President Putin’s geopolitical reasoning for invading Ukraine is that he has failed to commit to a total mobilization. If controlling Ukraine was so important to Russian national security, if it was indeed an existential risk that the country joins NATO, then why utilize only partial mobilization? As such, Ukraine may have only a quarter of Russia’s available manpower to throw at its defense, but Russia is unwilling to commit to the war fully. We are not surprised by this given our starting point that the war is optional for Russia, not existential.
- **Geography:** The combined length of the Ukrainian front is comparable to the Western front in World War One. The two combatants, however, have *far* fewer men fighting in the trenches arrayed against one another in this conflict. As such, it is very difficult to see how Ukraine is going to break through the well dug-in defenses, which Russian troops have had over six months to prepare.

Given these factors, it is highly unlikely that the Ukrainian offensive will create a breakthrough. So far, their efforts have been paltry, which has not surprised us at all (**Map 1**). Not only that, but we also believe that Ukraine is making a strategic mistake by going on an offensive. It has not received enough offensive weapon systems from the West, those that it received it has not trained long enough on, and it does not have the manpower to manipulate such an incredibly sizeable line of contact. So why is Kyiv on the offensive?

MAP 1 | Ukrainian Offensive Has Been a Failure



President Volodymyr Zelenskyy is being pushed into this action by politics. Like a tech startup CEO pushed by his VCs into revenue-generating activity too early, Zelenskyy feels pressured to prove that the generous Western military aid has not gone for naught. There is also chatter in the media by NATO and US military officials that gaining territory would improve Kyiv’s “negotiating position” against Moscow.

Just as with the standoff in Bakhmut, politics – rather than military strategy – is now dominating decision making. In our view, the political decisions to make the stand at Bakhmut and now to launch an offensive are likely to cost Ukraine initiative, manpower, and many weapon systems.

While it is not politically correct to say so, this outcome is the most sanguine for the market. As the bond market told us throughout 2022, the market does not care about southern and eastern corners of Ukraine. A conflict that ensnared Kyiv in a brutal urban combat or brought Russian tanks and fighter jets close to NATO borders, such a war would have potentially mattered for the markets. But few in the West could find Donetsk, Luhansk, Kherson, and Zaporizhia on the map before this conflict. And for good reason. These oblasts are largely irrelevant for the global economy or global balance of power. They're not even that strategic for Ukraine, which retains its access to the Black Sea via Odessa – and has access to the Baltic Sea anyhow via its staunch allies Poland and the Baltic states.

As such, a failed Ukrainian offensive that ends up ossifying the conflict further may not be something Western politicians are willing to admit they are hoping for, but we think they are. The alternative is that a Ukrainian offensive makes a dramatic breakthrough, forcing Russia to either retaliate or turn up the heat – so to speak – with non-conventional warfare.

In our view, the Kremlin has a hierarchy when it comes to the oblasts conquered in Ukraine. Crimea is considered a part of Russia and has been annexed officially for nearly a decade. The two oblasts that make up Donbas, Luhansk and Donetsk, are also considered Russia, but Moscow may be willing to consider modifying its borders. This is not what the annexation order of September 30, 2022, said. Both oblasts were annexed with their current borders. However, we think that Moscow would be open to some modification, if forced to by the realities of war. When it comes to Zaporizhia and Kherson, our view is that their annexation is purely transactional. Zaporizhia is a land bridge to Crimea, whereas Kherson provides Crimea with a buffer and water supply. As such, Moscow would be willing to lose almost all of its hold on both. In fact, Kremlin spokesman Dmitry Peskov said as much when asked to clarify Moscow's desired borders.⁸

While Moscow may be open to modifying its desired borders in Kherson and Zaporizhia, it does consider Crimea Russia. As such, a Ukrainian offensive that threatens Moscow's control of Crimea would, in our view, be considered an attack on Russia proper, whereas the Kremlin probably considers continued warfare in the other four oblasts as “fair game.”

Therefore, if a Ukrainian offensive were to threaten Crimea, we could see geopolitical risk premium seep back into the markets. And if it did not, we would recommend investors bet that it would.

Given our analysis, we have a high conviction view that the Ukrainian offensive will largely fail. Ukraine will certainly win back some territories and the Western propaganda machine may even declare the offensive a “success.” However, it is unlikely that the gains are meaningful.

One risk to this view is the Wagner mutiny. While it is easy to do “order of battle” analysis between armies, it is far more difficult to gauge *esprit de corps*, the morale of troops. This is a highly qualitative factor that operates

⁸ Please see Newsweek, “[Russia Admits It Doesn't Know Where Its Western Border Is After Annexation](#),” dated October 3, 2022, available at [newsweek.com](#).

in non-linear fashion. In other words, when morale is lost, troops are routed and flee the field of battle. This can occur even when there is no clear numerical or material advantage to one combatant over the other.

What happens once the Ukrainian offensive exhausts itself? We suspect that the fissures that are clear for all to see between Western Europe on one side and Kyiv, the US, Poland, the Baltic States, Nordics, and the UK on the other will deepen. France, Germany, and Italy will want the war to end. Russia, if it knew what was good for it, may declare victory. And if none of that happens, the war will simply ossify, the way that the Korean War never ended or that the Azerbaijan-Armenia conflict simmered for 25 years – with constant warfare each year, out of the attention of the rest of the world – until Azerbaijan’s offensive in 2020.

At some point, it would behoove Ukraine to learn from Azerbaijan’s example. Azerbaijan waited for over two decades to reconquer territories lost to Armenia. During those two decades, it spent its considerable energy wealth on developing a modern army. If Ukraine loses this offensive, it is not the end of the world. The right strategic move would be to refocus on economic development and developing a modern military, a multi-year process that may stretch for decades. However, we have little conviction that Kyiv would pursue this path given the high level of passion and emotion that the conflict has enflamed.

Bottom Line: As far as the market is concerned, the war in Ukraine has been over for over six months. We have consistently stated to our clients that our expectations of the ongoing offensive are low. The Wagner mutiny does increase the odds that Kyiv’s troops make a non-linear breakthrough due to the collapse in Russian morale. While the probability is low, the market is completely unprepared for such an outcome given the complete collapse of the geopolitical risk premium in almost all financial assets. While our highest conviction view remains that this war is essentially over, ossified, and heading towards “frozen conflict” status, there is little remaining alpha available to harvest from such an outcome. The market completely and utterly agrees with us. The easy “wins” – well, easy for us at least – are over.

Crime and Punishment – The Mutiny Is Merely a Symptom of a Deeper Rot

At the onset of the conflict, we penned the following paragraph:

Policymakers are not always aware of their material constraints. They may misjudge them. Or they may completely ignore them, irrationally. As such, the constraint-based framework is not always right, initially. However, if our assessment of the material constraints facing Russia in Ukraine is correct, then there will be consequences for President Putin for having misjudged them.

The Wagner mutiny is the punishment that the constraint framework has doled out to the Kremlin. It is the natural reaction to President Putin’s extremely bungled action.

The analytical, commentary, and Twitterati community fall into two camps. Those who believe that Russia is doing just fine in the conflict and those who – like us – believe that the war has been a disaster for the country.

The sanguine side of the ledger believes that the initial assault on Kyiv was a “head fake.” That much as the Russian invasion of Georgia in 2008, President Putin had more limited goals. In that conflict, Russian troops were just outside of Tbilisi, the capital, but then withdrew back into Russia once the two regions of Georgia that Moscow wanted were occupied – South Ossetia and Abkhazia. As such, Putin got exactly what he wanted with the February 24, 2022, invasion. It is the West that thinks he overreached.

We disagree with this view. The initial assault on Kyiv was not a head fake. Russia withdrew because it could not hold Kyiv suburbs and Chernihiv. It then abandoned the entire oblast of Kharkiv and the city of Kherson, its major urban conquest of the war.

Those who believe that Russia is doing all right in the conflict are puzzled by the Wagner mutiny. It is this community that has largely spread and propagated rumors that the entire episode was a conspiracy theory. Because Russia could not be at a precipice of a disastrous collapse, the mutiny must have been staged.

We would be open to this view had we not actually translated Prigozhin’s thirty-minute diatribe on Telegram, the social media platform, that he gave ahead of the mutiny.⁹ In this fascinating speech, Prigozhin said a few real gems:

- *“Between 2014-2020 Donbas was looted by those close to the president, FSB, and oligarchs. These are people who stole from the people of Donbas. There was supposed to be local police/army presence to defend the population in case on a Ukrainian attack.”*
- *“On February 24, nothing out of the ordinary was happening. The Ministry of Defense (MoD) is trying to lie to the administration and population that there was excessive aggression from Ukraine’s side and that they were trying to attack Russia with the entire NATO.”*
- *Now, why did the “special operation” begin? Pretty concepts like de-Nazification and de-militarization of Ukraine would have been possible if, in three days, there was a regime change.”*
- *“As far as I know, Zelensky was open to anything when he became president. All we had to do was get down from our high horse and go make a deal. The entire Western Ukraine is populated by genetically Russian people. What is happening now is that we are just killing Russians.”*
- *“A bunch of idiots thought that nobody would realize what they were up to with their military training exercises right before their stupidly planned operation, and they stupidly thought that no one would stop them when they marched on Kyiv. And no one would have stopped them if these degenerates wouldn’t have made long columns and didn’t send naked and barefoot soldiers to Kyiv and other regions.”*
- *“When we captured factories, why didn’t we start working in them? Instead, all the machinery gets disassembled and taken to Russia. We captured a liquor factory, and already it’s being decided when it should launch. But who will profit from it? Definitely not the people of Donbas. All the revenues will be robbed and looted again. Our war with those who oppress Russians has turned into looting and stealing. Looting and stealing elevated to the levels of national ideology.”*

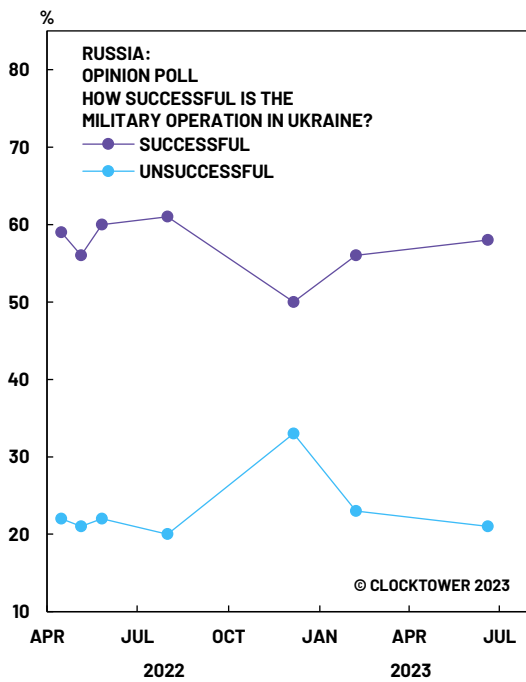
⁹ Please see Prigozhin, [“Публикуем первую часть большого интервью Евгения Пригожина,”](#) dated June 23, 2023, available on Telegram.

We largely agree with most of what Prigozhin had to say. Especially that Moscow could have negotiated with President Zelensky early in the conflict, when Kyiv was open to giving Russia a guarantee it would never join NATO. In addition, Prigozhin points out that the initial invasion was executed poorly, particularly the large columns of mechanized armor getting stuck on roads, easy pickings for Javelin-wielding Ukrainians.

The diatribe is important as it makes it highly unlikely that the mutiny was a grand Kremlin conspiracy. Prigozhin is a Russian nationalist who just spent 18 months fighting Ukrainians on the front line. He is not some pro-West NGO director who can easily be dismissed as a “dove” or a patsy of the West. As such, his words matter, and they widen the acceptable narrative inside Russia. A narrative that now includes criticism of the Kremlin.

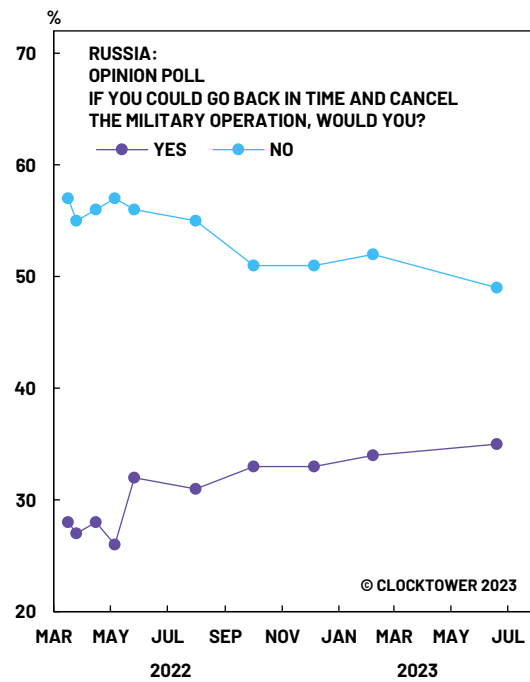
Russians largely consider the military operation as “successful,” (Chart 10) but the percent that would “cancel” the invasion if they could go back in time is rising (Chart 11). In other words, there is rising “regret” among the population.

CHART 10 | Russians Think War Is Going All Right...



SOURCE: RUSSIAN FIELD RESEARCH.

CHART 11 | ...But Regret Is Rising



SOURCE: RUSSIAN FIELD RESEARCH.

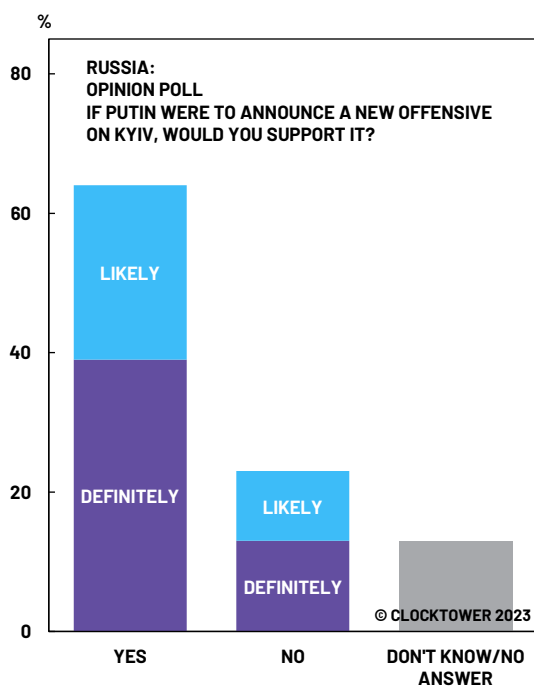
We predicted that this would happen in our earlier assessments of the conflict. Yes, patriotism is at a high, particularly given West’s support for Ukraine and the sense within Russia that the entire country is fighting the US. However, as time goes on and casualties mount, Russians will ask themselves the obvious question of “was it all worth it?” Given that the regions of Ukraine that Russia has conquered have no natural resources (no, coal does not count, it’s 2023, not 1813) or strategic value (Russia already has access to the Black Sea, a NATO lake inside a larger NATO lake – please look at an Atlas if you disagree) – the regret will hit hard.

Intriguingly, polling data from Russia suggests that a majority would both support a new offensive on Kyiv (Chart 12) and a peace deal (Chart 13), likely reflecting that they pretty much agree with whatever President Putin

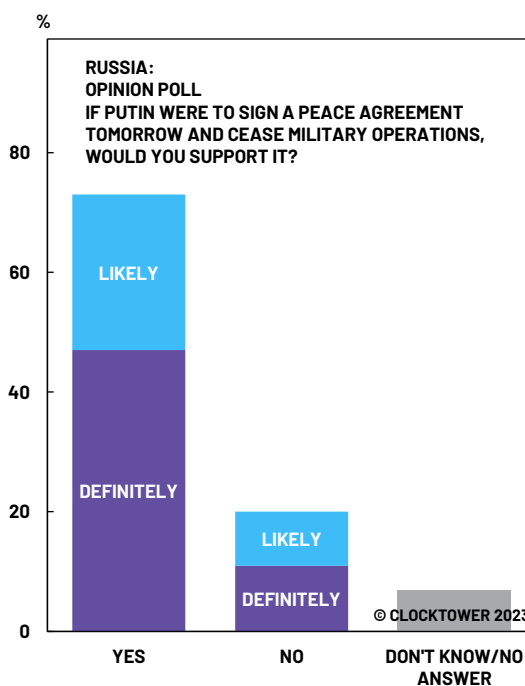
decides to do (or want to project that sense when answering polls).¹⁰ But it also illustrates that the country is divided between those supporting continued war and peace negotiations. In fact, the gap between the two desired outcomes is closing fast (Chart 14), led by the younger respondents (Chart 15) – who invariably are more likely to be mobilized for war – by those of modest income levels (Chart 16) and the less educated (Chart 17). This social/wealth/education distinction is intriguing. The older, well off, educated members of Russian population still support the war whereas the younger, poorer, and less educated have had enough of it.

CHART 12 | Russians Would Support an Offensive...

CHART 13 | ...Or a Peace Deal



NOTE: DATA AS OF JUNE 16-19, 2023.
SOURCE: RUSSIAN FIELD RESEARCH.



NOTE: DATA AS OF JUNE 16-19, 2023.
SOURCE: RUSSIAN FIELD RESEARCH.

Of course, none of this really matters as the odds of another offensive rest on further mobilization. When Russian population was asked if they would support continued war – over peace negotiations – if another draft was necessary, there is no majority in favor of war (Chart 18), with only the most educated apparently in favor of continued conflict (Chart 19).

This is a problem for President Putin as he has always had high levels of support among the lower income and less educated segments of society. Until 2021, President Putin never experienced widespread protest outside of the educated intelligentsia in St. Petersburg and Moscow. In 2021, protests against structural reforms and handling of the COVID-19 pandemic did spread throughout the country, revealing cracks in Putin’s support.

Continued warfare is likely going to continue to build resistance among the low income, less educated, members of Russian society. After all, they are the ones most likely to be drafted, given that they cannot send their kids to enjoy the wine in Tbilisi or the nightlife in Belgrade to escape the draft.

¹⁰ Russian Field Research is a relatively new polling organization. While all Russian polling should be taken with a grain of salt, Russian Field has shown more neutrality and has openly recognized that propaganda and fear of retaliation plays a role in collecting polling data.

CHART 14 | Rising Support for Peace Talks...

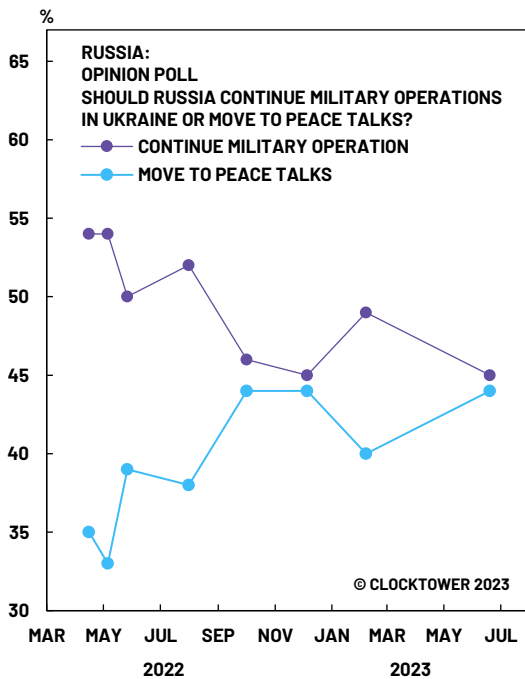


CHART 15 | ...Especially Among the Young

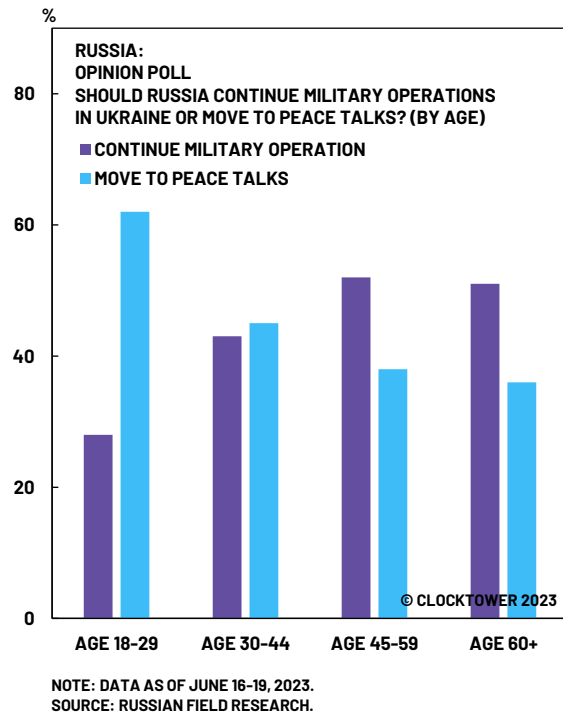
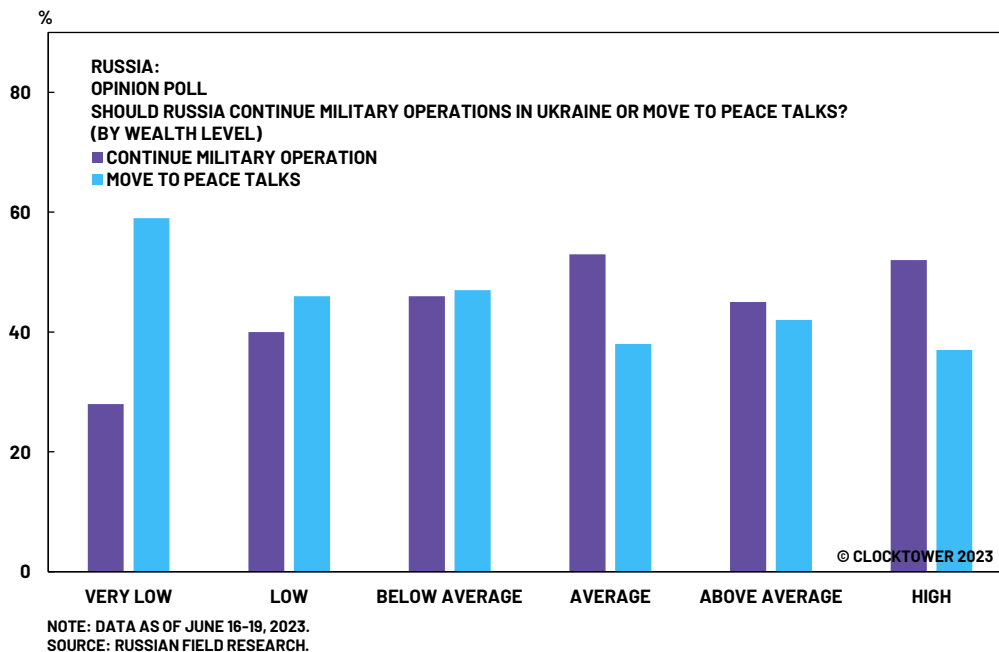


CHART 16 | Low Income Russians Are Least Supportive of Continued War



In our view, President Putin has an opportunity to declare victory following the likely failure of the Ukrainian offensive and wrap up the conflict. If he fails to do so, he is likely to see continued deterioration of support for the war. His own election – scheduled for March 2024 – is fast approaching. Polling suggests that the public is divided on whether they want to see Putin return to power (Chart 20), with a clear majority opposed to the election being cancelled on some emergency pretense (Chart 21).

CHART 17 | The Most Educated Are Also the Most Aggressive

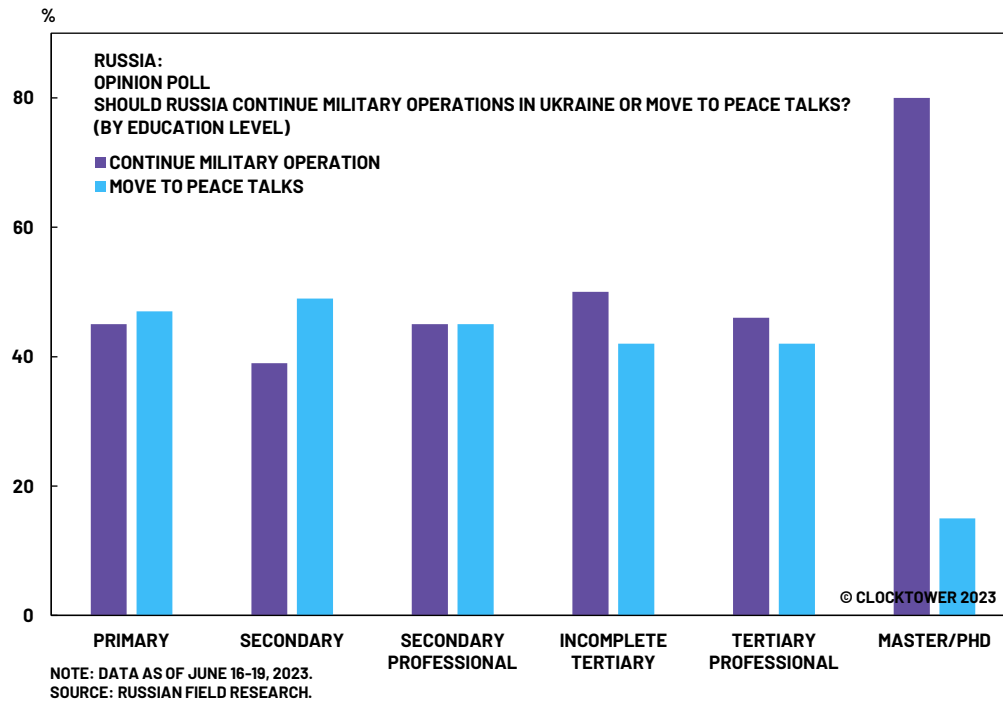


CHART 18 | Majority of Russians Want to Move to Peace Talks if Another Mobilization Is Needed for War

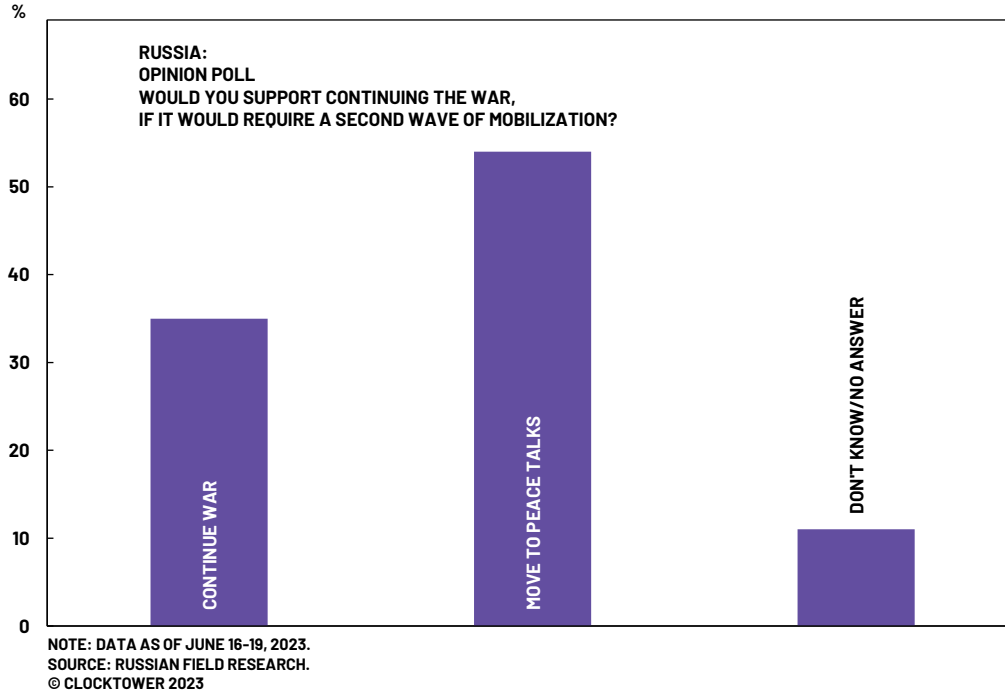


CHART 19 | Only the Most Educated Seem to Be Interested in Another Mobilization (Since They Can Avoid it)

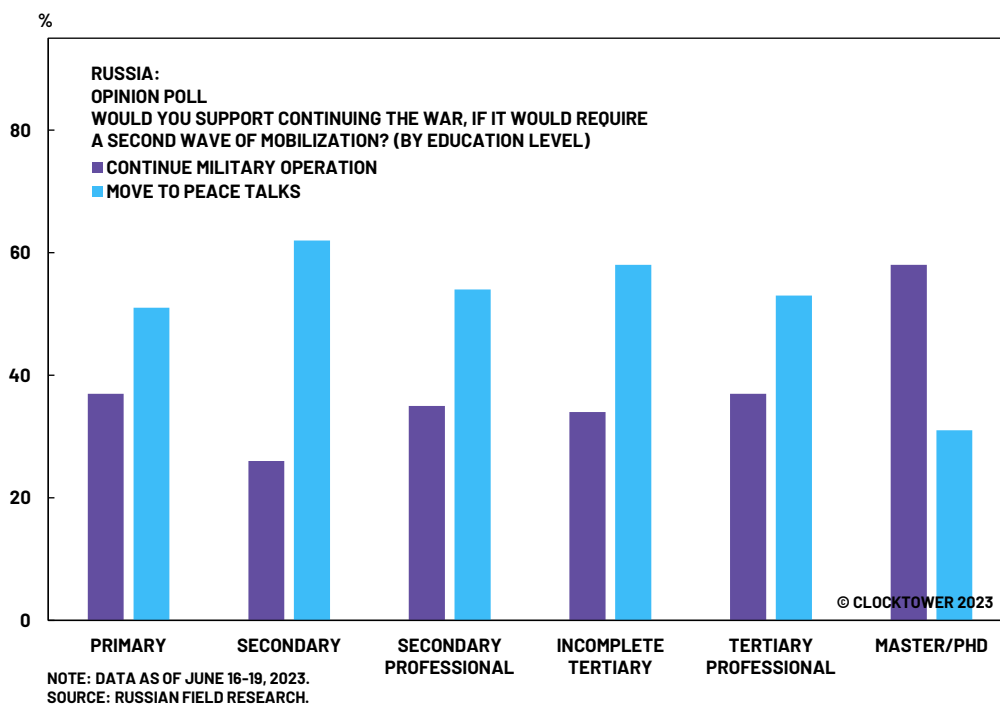
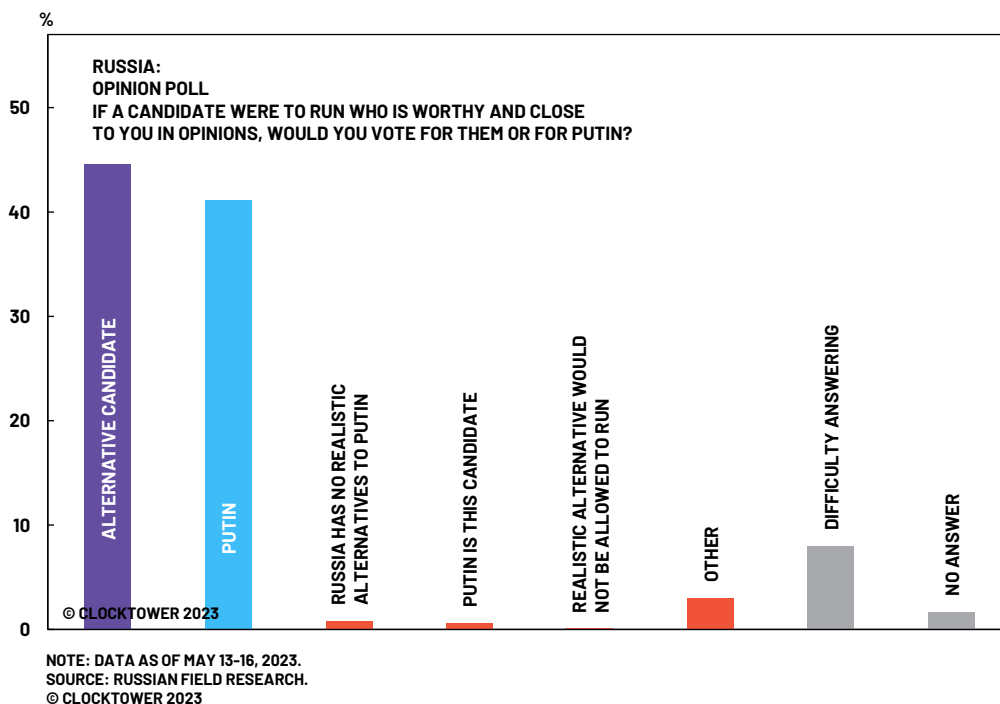


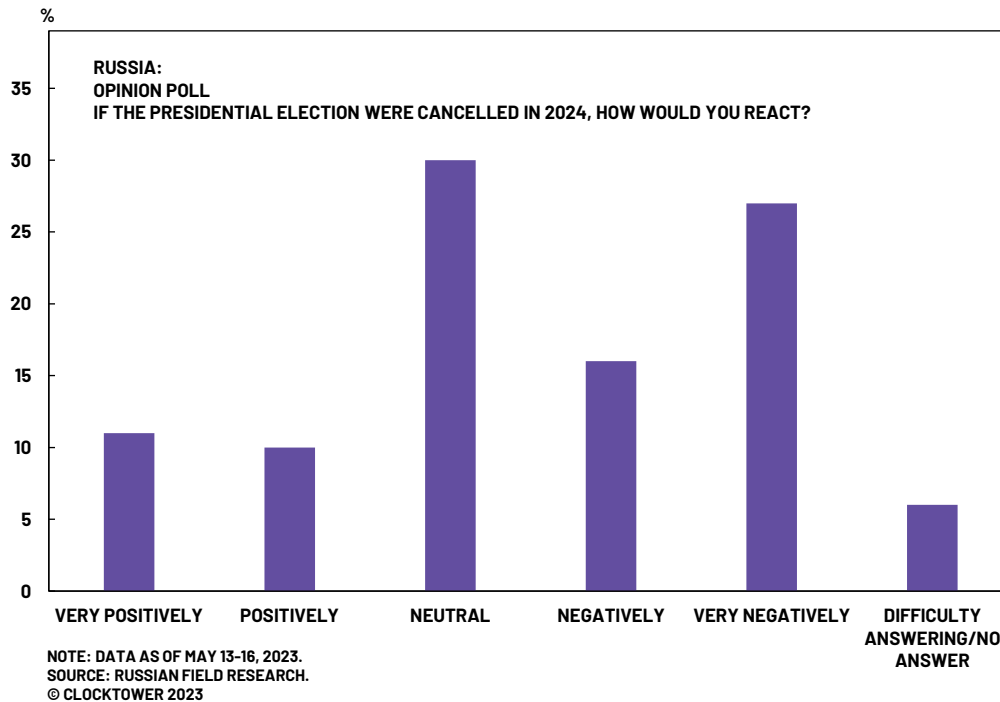
CHART 20 | A Plurality of Russians Is Willing to Vote Against Putin



The writing is on the wall for the current regime in the Kremlin. The war is increasingly seen as a burden on the least educated, poorest, members of the Russian society. An increasing number of Russians are open to

negotiations and an end to the war – yet another feather in the cap of those of us who do not believe the conflict was existential, but rather optional, for Moscow.

CHART 21 | Very Few Russians Want the Election to Be Cancelled

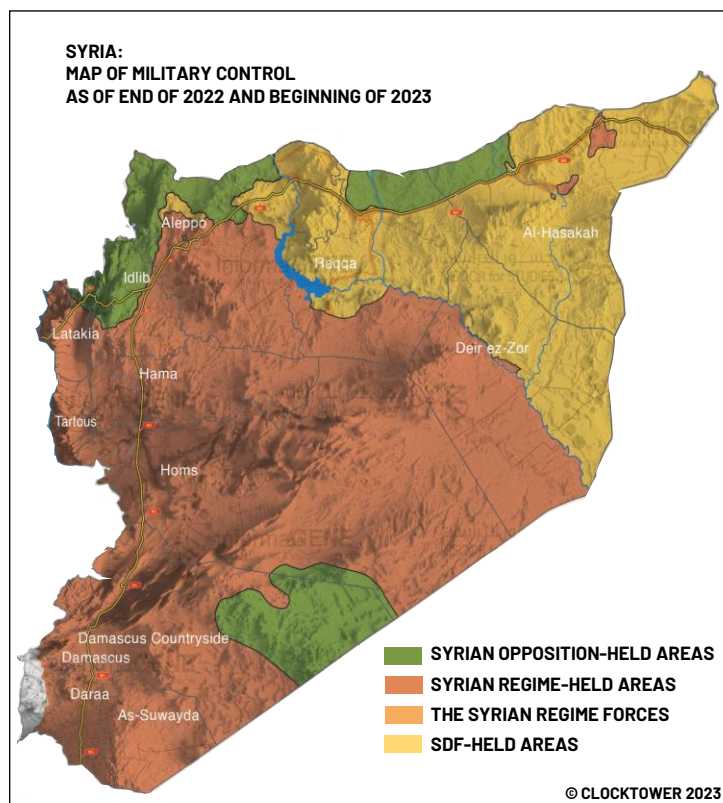


Continued offensive operations in Ukraine will further inflame domestic opposition to the war. When combined with the incredibly lenient treatment of Yevgeny Prigozhin and his co-conspirators, it is inevitable that President Putin will face further challenges to his rule.

The problem for investors is that the potential outcomes that we see as possible range from a gentlemanly coup – the kind that brought Putin to power by sidelining President Boris Yeltsin – to an absolute and utter collapse of Russia as a state. Furthermore, we could see a world where Putin stays in power for the remainder of the decade, but with an increasingly shrinking space of institutions, territory, and material wealth under his writ. An outcome akin to the “victory” by Syrian President Bashar al-Assad, who remains in control of merely 60% of his country today (Map 2).

This would be very similar to Russia in the 1990s, where various oligarchs and regional leaders took *de facto* power into their own hands. While most of our readers in the West remember the insurgencies in Dagestan and Ingushetia, as well as the two wars in Chechnya, few probably remember that the oil rich Tatarstan had a semi-sovereign status from 1994 to 2017, when Moscow ended its special status. A number of other regions of Russia – where various ethnic minorities make up a majority, or close to it – could begin the unraveling of Russia. That unraveling does not have to look like ethnic conflict in Yugoslavia. Instead, these regions would simply retake the sovereignty they gained in the 1990s at the expense of Moscow, robbing the central government of critical revenue.

MAP 2 | Al-Assad Is in Control of a Shrunken State in Syria



SOURCE: JUSOOR.

While most of our Western readers are likely cheering such an outcome, we have to point out that the current economic cycle is a capex-driven one (Chart 22).¹¹ And capex-driven cycles need a *lot* of commodities (Chart 23). Russia is the world’s largest exporter of commodities. In the 1990s, Russia saw a significant deterioration in oil production as domestic political uncertainty made investment in new production, human capital, and advanced technology difficult (Chart 24). Given that the 1990s were a *tech*, not a capex, led decade, Russia’s agony was largely Russians’ problem. But today, with Western policymakers committing themselves to everything from magically de-risking of supply chains away from China to (even more magically) solving climate change by “Tuesday,” the loss of Russia’s productive capacity *would* be highly relevant.

This is why we mentioned “Russian destabilization” as one of the pillars of the secular commodity bull market in our April net assessment.¹² As we argued then:

Russian destabilization: *The war in Ukraine has been a disaster for Russia militarily, geopolitically, and potentially – in the near future – politically. Domestic political insecurity could create an environment uncondusive to capital investment – to put it mildly. Regime change could create complete chaos in the world’s largest exporter of commodities. This could lead to a severe decline in production. Russia has already*

¹¹ Please see Clocktower Group, *All Along the Clocktower*, Volume II, “Geopolitics Is Not Transitory,” dated November 2021, available on request.

¹² Please see Clocktower Group, *All Along the Clocktower*, Volume II, “Commodities: Is the Supercycle Still On?” dated April 2023, available on request.

announced oil production cuts amounting to 6.7% of its exports. While these cuts are flagged as retaliation for Western sanctions, that may simply be rhetorical cover for problems with maintaining production given a lack of Western technology and knowhow.

CHART 22 | A Capex-Driven Cycle Needs...

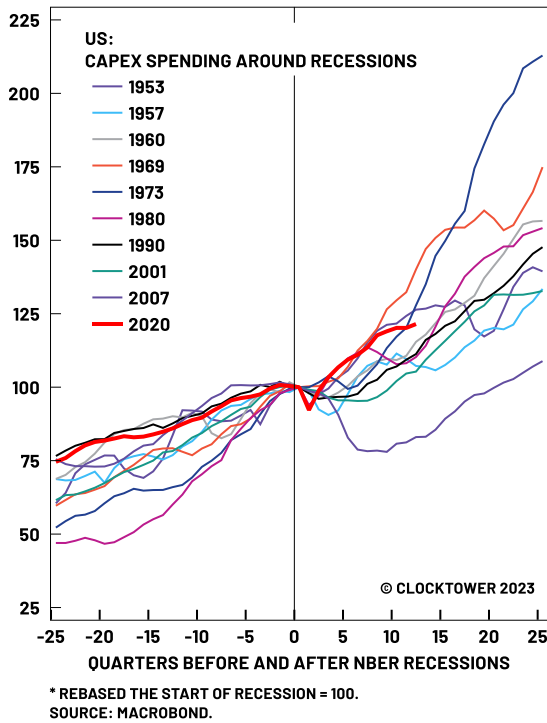


CHART 23 | ...A Lot of Commodities

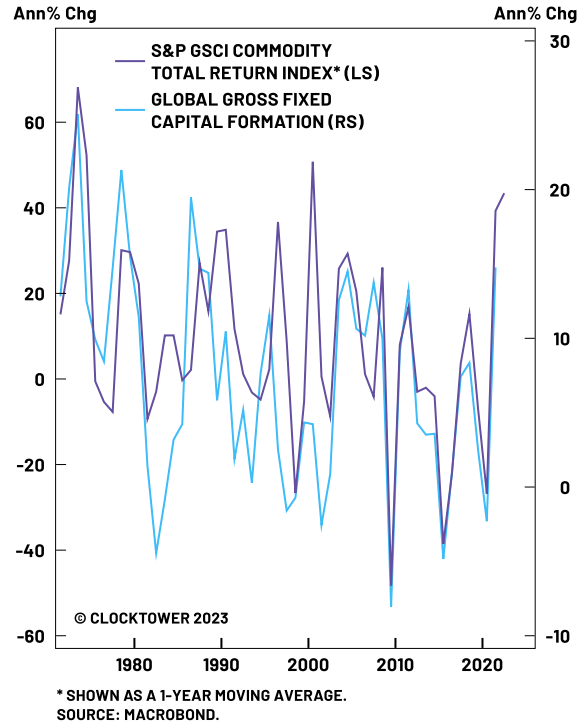
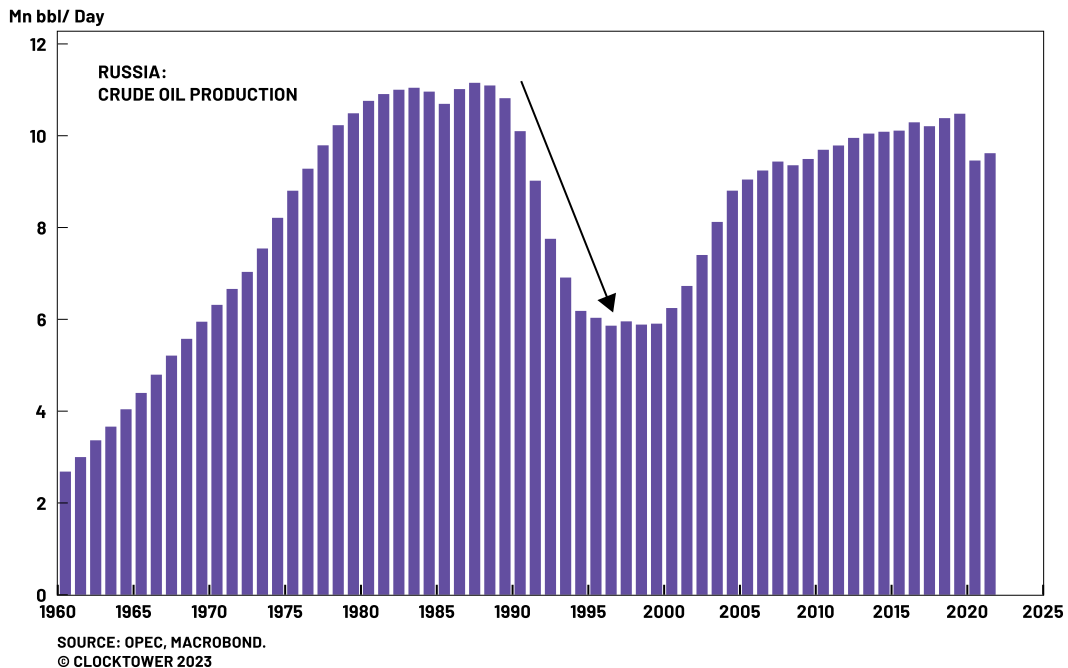


CHART 24 | Russia's Domestic Political Unraveling in the 1990s Cost the World Commodity Supply



Bottom Line: The Wagner mutiny was no conspiracy theory. It was merely a symptom of a deeper rot that has struck Putin's rule well before the intervention in Ukraine. In our view – which almost nobody shares with us – the invasion of Ukraine was conducted for the petty reason of forestalling regime change. But, as such moves often do, it has now backfired and has accelerated it.

Given that geopolitical risk premium has drained from the market, it is difficult to “fade” the risk of immediate regime change. If anything, the Wagner mutiny increases risks that Ukraine has a breakthrough in its offensive or that President Putin triples down on the war. We do not have either scenario as likely. But, the market is clearly not positioned for such a risk off scenario given that it agrees with us that the war in Ukraine has been “over” – as far as markets are concerned.

The only high conviction view that we have is that a destabilization of Russia is now in full effect. This does not mean that President Putin's days are numbered. We think they are, but Russia can destabilize with Putin still cocooned in the Kremlin. His rule may simply not mean much outside of its walls. It is difficult to “bet” on this outcome, other than to expect that commodities should be in a secular bull market over the long term.

Will China Come to the Rescue of Russia?

The final question for investors is whether Beijing will come to save its purported ally. Since the start of the war in Ukraine, Western media and policymakers have tried to make a link between the war and Beijing. As we posited at the very onset of the conflict, China would choose neutrality lest it usher in a bipolar world that it cannot win.¹³

This view has proven correct. China has refused to ship advanced military tech (**Chart 25**) – or any military equipment whatsoever – since the beginning of the conflict. Its EU envoy Fu Cong – either advertently or inadvertently – has just revealed Beijing's support for Ukraine's 1991 borders – that include Crimea and the Russian annexed oblasts¹⁴ This is significant because Beijing's previous statements on supporting the territorial integrity of all countries are rather ambiguous, without first identifying the specific territories of Ukraine. The implicit recognition of Ukraine's 1991 borders thus likely suggests a strategic rethinking within Beijing about its relationship with Moscow following the Wagner mutiny. Furthermore, there are rumors that Lu Shaye – China's pugnacious Ambassador to France who posited that Ukraine was not a sovereign state¹⁵ – is about to be recalled back to China and will be transferred to an unimportant position. A clear signal from Beijing that it considers its relationship with Western Europe as more strategic than its alliance with Russia.

Beijing's statement at the onset of the Wagner mutiny also stated that China supports Russian stability, without mentioning Putin himself. According to the Ministry of Foreign Affairs spokesperson:

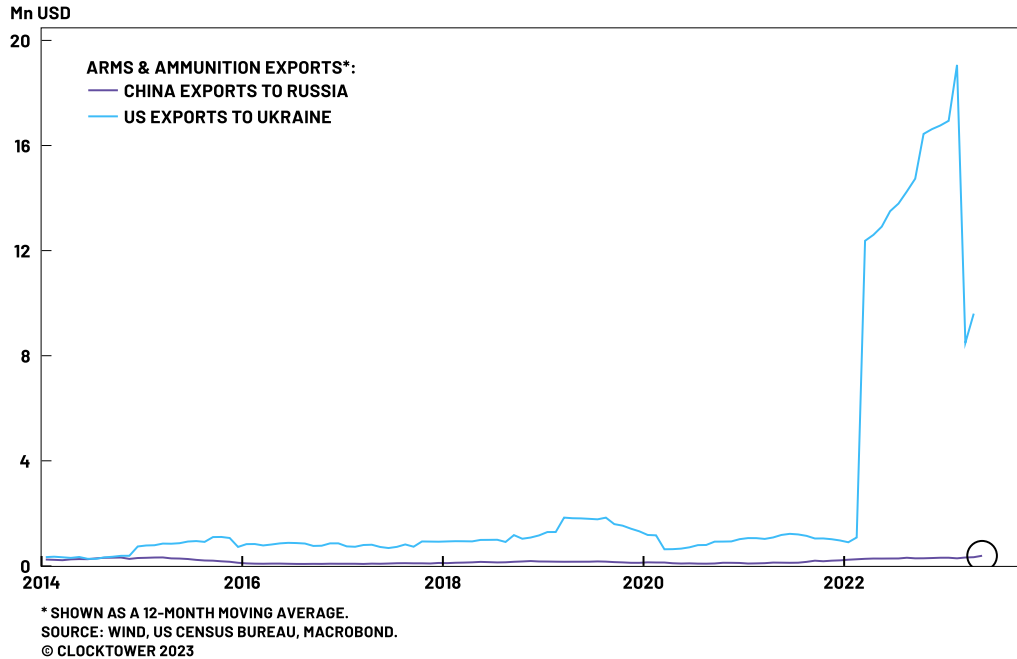
¹³ Please see Clocktower Group, *China Macro Watch*, “Is China Uninvestable Following Russia's Invasion of Ukraine?” dated March 15, 2022, and *All Along the Clocktower*, Volume II, “Will China Usher in A Bipolar World?” dated April 2022, available on request.

¹⁴ Please see Aljazeera, “[Don't see why not: China envoy on backing Ukraine's '91 borders](#),” dated June 27, 2023, available at Aljazeera.com.

¹⁵ Please see Reuters, “[Factbox: Lu Shaye: Chinese envoy who questioned Ukraine's sovereignty no stranger to controversy](#),” dated April 24, 2023, available at reuters.com.

"The Wagner Group incident was Russia's internal affair. As Russia's friendly neighbor and comprehensive strategic partner of co-ordination for the new era, China supports Russia in maintaining national stability and achieving development and prosperity."

CHART 25 | China Has Refused to Support Russia

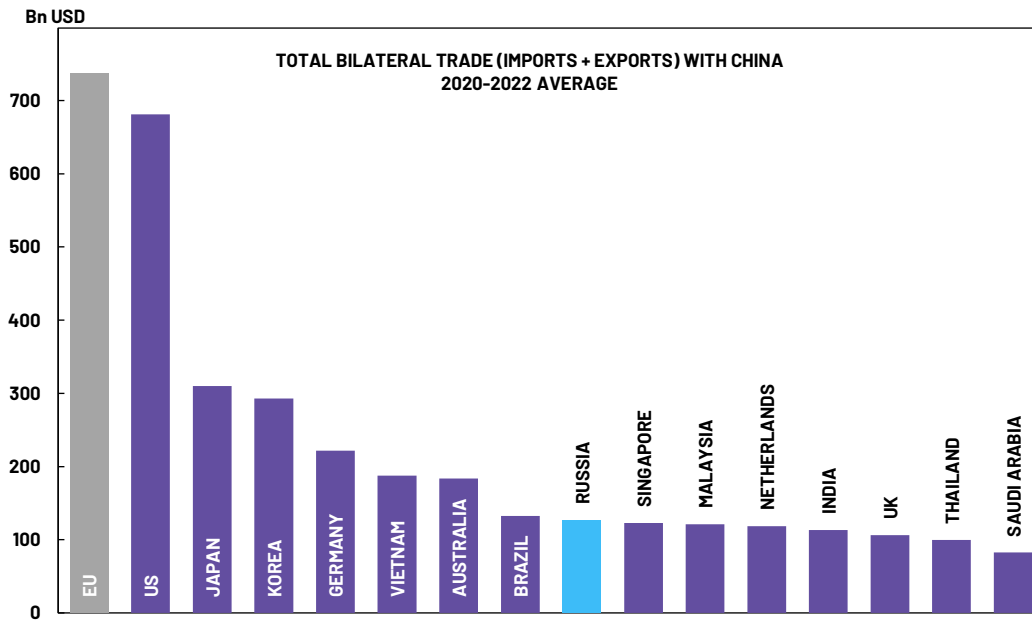


From China's perspective, Russia is a terrible ally. Moscow's performance in Ukraine suggests that China would not be able to depend on Russia for any military aid in a conflict against the West. Further considering the paltry economic, financial, and cultural interactions between the two countries, there has been a rising skepticism among Chinese intellectuals about the strategic benefits of the purported no-limits friendship (**Chart 26**). It is now widely believed by onshore commentators that the only benefit that Russia brings to China, besides commodity supply, is merely distracting the Western attention and thus delaying a full-blown Sino-US confrontation.

But in our view, a complete collapse of the Russian state may be an even better outcome for Beijing as the destabilization of the world's largest nuclear arsenal will weigh on global policymakers and force the US-China rivalry to the backburner. In addition, a period of instability in Russia could offer China the opportunity to increase its influence in commodity-rich Central Asia, particularly Kazakhstan, and to make lucrative economic deals with various regional power brokers in a much less centralized Russia.

Beijing's characterization of the Wagner mutiny as Russia's internal affair is a signal that China is unlikely to provide any direct support to the Putin regime. It is worth noting that one of China's long-held five foreign policy principles is "non-interference in each other's internal affairs." If Beijing tries to get involved and stabilize the Putin regime for the sake of keeping Russia anti-West, it would constitute an outright breach of its own foreign policy principles that will only justify the US interference in the cross-Taiwan Strait affairs. As such, both strategic and operational constraints have determined that Beijing is unlikely to come to Putin's rescue this time.

CHART 26 | Even after the No-Limit Partnership Quip, Russian Trade Is Not Critical to China



SOURCE: IMF DIRECTION OF TRADE STATISTICS, MACROBOND.
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In conclusion, we want to leave readers with one of our favorite Warren Buffet quotes, which we have modified for macro-geopolitical use:

I try to invest in ~~businesses~~ countries that are so wonderful that an idiot can run them. Because sooner or later, one will.

President Putin has been a very keen strategist for most of his time in power. He handled the Second Chechen War with deft diplomacy – getting Chechens loyal to the Kremlin to end the war on Russia’s behalf – he pushed back on the 2004 Orange Revolution in Ukraine with patience and economic pressure, ushering in a pro-Russian candidate via a democratic election in 2010, he gained international respect with high-ROI, and limited, military interventions throughout Africa and in Syria. Even the intervention in Ukraine post-2014 was relatively restrained, with the annexation of Crimea proceeding relatively peacefully.

However, the 2022 invasion of Ukraine was – objectively – a mistake. Nobody will come to the aid of Russia, it is very much on its own. President Putin will either pivot from the war, or cause Russia to enter another *Time of Troubles* (Смутное время). For many in the West, this is a welcome outcome. In our view, destabilization of Russia could easily evolve into the greatest geopolitical risk of this century. At the very least, it will stymie Western enthusiasm for countering China or solving climate change, as commodity prices soar due to the political collapse of the world’s greatest commodity exporter.

Questions/Comments?

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